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CHAPTER 1 - NATURE, SCOPE AND OBJECTIVES OF AUDIT

CONDUCT
3) Settlement of trade disputes
4. Proper maintenance of books of account
1. Protect interest of investors
2. Moral check on employees
MORAL
8. Protect interest of investors

Meaning
Audit is independent examination of financial information of any entity, whether profit oriented or not, and irrespective of its size or legal form, when such an examination is conducted with

Note: The user shouldn't assume that auditor's opinion is an assurance to the future viability of the enterprise or the efficiency/effectiveness with which it has conducted affairs of the enterprise.

QUALITIES OF AUDITOR
- Objectivity, Integrity and Independence
- Confidentiality
- Communication skills
- Tacit approach
- Clear headedness and common sense

TECHNICAL
- Sound knowledge of following:
  a) Accountancy
  b) Auditing
  c) Direct & Indirect tax
  d) Corporate Law
  e) Client nature of business

OVERALL OBJECTIVE OF AUDITOR
a) To obtain reasonable assurance that FS are free from material misstatements
b) To report on the FS and communicate as required by SAs.

ASPECTS TO BE COVERED IN AUDIT
a) Examination of Act & IC system
b) Reviewing the system & procedures
(c) Vouching of the transactions
(d) Verification of Assets & Liabilities
(e) Expressions of Opinion

SCOPE OF AUDIT
- "Audit should cover all relevant aspects of FS & Info is reliable & Sufficient to form Opinion
- Evaluation of I.C & A&C system to check reliability of Audit evidence Info
- Relevant Info disclosed in FS subjects statutory requirement
- Auditor not expected to perform duties fall outside scope of his competence
- Constraints on the scope of the audit"

ADVANTAGES OF AUDIT
1. Protect interest of investors
2. Moral check on employees
3. Settlement of trade disputes
4. Settle trade disputes
5. Detention of wastages
6. Proper maintenance of books of account
7. Admission/removal of partners
8. Appraisal of controls

SA 220 Quality Control for an Audit of Financial Statements

SA 200 Overall Objectives of the Independent Auditor and Conduct of the Audit in Accordance with SAs

AUDIT OF FINANCIAL STATEMENTS

INDEPENDENCE OF AUDITOR
Meaning - As per OR, Independence implies that judgement of a person is not subordinate to wishes/directions of another person who might have engaged him.

ACCEPTANCE & CONTINUANCE OF CLIENT RELATIONSHIP & AUDIT ENGAGEMENT
EP satisfied that appropriate procedures have been followed
EP obtains info that would have caused to decline the engagement

INDEPENDENCE OF MIND
State of mind permits provision of opinion without being affected by influences allowing individual to act with integrity, exercise objectivity & professional skepticism

EXAMPLE OF SUCH INFO
1. Integrity of mg & owners
2. Competency of ET to perform the engagement
3. Compliance with ethical requirement
4. Significant matters during current/previous audit

SAFETY FEATURES FOR QUALITY OF AUDIT
EP should emphasize:-
1. Compliance with professional std & legal requirements
2. Compliance with firm's QCP
3. Issuance of appropriate audit report
4. Ability to raise concerns without fear
5. Quality is essential & indispensable

INDEPENDENCE OF AUDITOR not only to exist in fact but also appear to so exist to all reasonable persons

RESPONSIBILITY OF EP
1. Determine EQR has been appointed
2. Discuss significant matters with EQR
3. Not data report before EQR review

RESPONSIBILITY OF EQR
1. Discuss significant matters with EP
2. Review FS & proposed audit report
3. Review selected audit documentation
4. Review conclusions reached

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Chapter 1 - Nature, Scope and Objectives of Audit

**Threats to Independence**

1. **Self Interest**
   - As a result of financial or other interests of accountant or relative
   - Examples: Direct financial interest; loan/guarantee; potential employment

2. **Self Review**
   - Previous judgement re-evaluated by person responsible for the judgement
   - Examples: Past employment with client; other service performed by auditor for client

3. **Intimidation**
   - Occurs when auditors deferred from acting objectively with adequate degree of professional skepticism
   - This could occur due to threat of replacement or pressure of reducing work in response to reduced fees

4. **Advocacy**
   - Auditor promotes opinion to point that subsequent objectivity is compromised
   - Examples: Auditor dealing with shares of client; becomes client's advocate in litigation

5. **Familiarity**
   - Auditor forms relationships with client where they become too sympathetic
   - Examples: Acceptance of gifts from client; relative of audit team working in client

6. **Safeguards to Independence**
   - Auditor should always be & appear to be independent
   - Auditor should abide with key fundamental principles of integrity, objectivity & professional skepticism
   - Auditor should consider threats to independence before accepting the engagement
   - In case of threat to independence - should not accept engagement unless necessary safeguards can be put

**Previous Judgement Re-evaluated by Person Responsible for the Judgement**

**SA 210 Agreeing the Terms of Audit Engagement**

**Preconditions for Audit**

1. FRF applied in preparation of FS is acceptable
2. Mgt acknowledges responsibility of
   - a) Preparation of FS in accordance with FRF
   - b) Exercising necessary IC for preparation of FS
   - c) Provide auditor with:
     - Access to all relevant info
     - Addn info as auditor request
     - Unrestricted access to persons within entity

**Agreement on Audit Engagement Terms**

1. Auditor to agree terms in writing
2. Terms to be recorded in writing & shall include:
   - a) Objective & scope of audit
   - b) Responsibilities of Auditor
   - c) Responsibilities of Mgt
   - d) Identification of FRF

**Reasons for Entity Request for Change in Terms**

1. Change in circumstances affecting need of service
2. Misunderstanding as to nature of audit as originally requested
3. Restriction on scope of engagement imposed by mgt or caused by other circumstances

**Acceptance of Change in Terms**

1. Auditor not to agree - there is no reasonable justification for the same
2. Prior to completing engagement - auditor required to change it to engagement conveys lower level of assurance - Reasonable justification for the change
3. Terms changed - Record in new engagement letter
4. Auditor not agree to change - Mgt not permit him to continue original engagement
   - a) Withdraw from engagement
   - b) Any obligation to report to TCWG/others

**Factors to consider for revision or reminder of existing terms:**

- a) Indication of misunderstanding of terms
- b) Change in senior mgt
- c) Change in ownership structure
- d) Change in nature & size of business
- e) Change in legal, regulatory and other reporting requirements

**Recurring Audit**

1. Auditor - assess circumstances require revision or to remind entity of existing terms

**Limitation Prior to Engagement Acceptance**

1. Changes in circumstances affecting need of service
2. Misunderstandings as to nature of audit as originally requested
3. Restriction on scope of engagement imposed by mgt or caused by other circumstances

**Don’t accept the engagement**
CHAPTER 2 - AUDIT STRATEGY, PLANNING AND PROGRAMME

Usefulness of Audit strategy

- Resources to deploy for specific area
- Amt of resources to deploy for specific audit area
- When these resources are to be deployed
- Mgr direction & supervision of resources

SA 300 - PLANNING AN AUDIT OF FINANCIAL STATEMENTS

Preliminary engagement activities
- Perform procedure:
  a) Understand terms of engagement (SA 210)
  b) Compliance with ethical requirements (SA 220)
  c) Continuance of client relationship (SA 220)

Auditor - establish overall audit strategy that sets scope, timing & direction of audit, & guides development of audit plan.

Developing Audit Strategy
- Identify characteristics of engagement that define its scope
- Ascertain reporting objectives
- Consider factors significant in guiding ET's efforts
- Consider result of preliminary engagement activities
- Knowledge of other entity is relevant
- Ascertain NTE of procedures

Developing Audit Plan
- NTE of risk assessment procedures as per SA 315
- NTE of further audit procedures (SA 330)
- Other planned procedures to be carried out (SA 330)

Audit strategy and Plan are the auditor's responsibility.

Benefits of Audit Planning
- Acquiring knowledge of A/C system, policies & IC account
- Expected degree of reliance on control
- NTE of audit procedures
- Coordinating work

Auditor to update & change overall audit strategy & plan as necessary during audit.

Audit Plan to cover
- A) Acquiring knowledge of A/C system, policies & IC account
- B) Expected degree of reliance on control
- C) NTE of audit procedures
- D) Coordinating work

Auditing of current audit
- Client not known to auditor
- Amt of resources to deploy
- Resources to deploy for supervision of resources
- Reliance on control
- A/c system, policies & IC
- Acquiring knowledge of specific area
- Coordinating work
- NTE of audit procedures
- Establishment of resources
- Auditing of current audit

Relationship bw Audit Strategy & Plan
- Audit Plan to be developed after establishment of Audit strategy taking into account the need to achieve audit objectives through efficient utilization of resources
- Establishment of strategy & detailed audit plan not necessary discrete/sequential processes, but closely inter-related
- Changes in one result in consequential changes to the other

- Planning not a discrete phase of an Audit, rather continual & iterative process
- Often begins shortly after completion of previous Audit & continues until completion of current audit

Acquiring knowledge of client's business
- Auditor to obtain understanding of:-
  a) Relevant industry, regulatory, other external factors & applicable FRF
  b) Nature of the entity, including:
    - Its operations
    - Ownership & governance structure
    - Types of investments made & planning to make
    - Entity structure & finance
  c) Selection & application of accounting policies, including reasons for changes thereto
  d) Its objectives & strategies, & business risks that may result in risks of material misstatement

Advantages of Audit Programme
- Provides assistant with clear set of instructions
- Provides total perspective of work to be performed
- Selection of assistants for jobs on the basis of capability becomes easier
- If work carried out on basis of mental plan - danger of ignoring over looking certain books and records.
- Assistants, by putting their signature, accept responsibility for work carried out by them
- Principal can control progress of various audits
- Serves as guide for future audits
- Serves as evidence in the event of any change of negligence being brought against auditor.

Auditor to update & change strategy & plan as necessary during the course of audit.
- As a result of unexpected events, changes in conditions, or audit evidence obtained.
- When info comes to his attention differs significantly from info available when he planned audit procedures.

Disadvantages of Audit Programme
- Programme tends to become rigid & inflexible
- Insufficient assistants take shelter behind programme
- Kill initiative of assistants

Series of verification procedure - applied for obtaining evidence - enable auditor to express

Evolving 1 Programme - Not Practicable for All Businesses
- There should be periodic review of programme to assess - same continues to be adequate for obtaining knowledge & evidence
- Any change in business policy of client may not be adequately known & audit work may be

Constructing an Audit Programme
(1) Stay within scope & limitation of assignment.
(2) Prepare written programme setting forth procedures needed to implement audit plan.
(3) Determine evidence reasonably available & identify best evidence to derive necessary satisfaction.
(4) Apply only those steps & procedures are useful in accomplishing verification purpose.
(5) Include audit objectives for each area & sufficient details to serve as set of instructions for assistants involved in audit & help in controlling proper execution of the work.
(6) Consider all possibilities of error.
CHAPTER 3 - AUDIT DOCUMENTATION AND AUDIT EVIDENCE

SA 230 AUDIT DOCUMENTATION

| Meaning | "It refers to record of audit procedures performed, relevant audit evidence obtained, & conclusions auditor reached." |
| "It provides: " | * Evidence of auditor’s basis for a conclusion about achievement of overall objectives; and * Evidence that audit was planned & performed in accordance with SASs & legal & regulatory requirements. |

SA 500 AUDIT EVIDENCE (AE)

| Meaning | "Info used by auditor in arriving at conclusions on which auditor’s opinion is based. It includes both info contained in A/c: records & other information." |
| Sufficiency of AE | * Materiality - Low materiality, higher samples * ROMM - Low ROMM, lower samples |
| Appropiatness of AE | * Source of Evidence * IPE of evidence - complete & accurate * Nature & dependent on individual circumstances under which it is obtained. |

SA 501 AUDIT EVIDENCE - SPECIFIC CONSIDERATIONS FOR SELECTED ITEMS

| Inventory - Existence | When inventory material to FS, auditor obtain sufficient appropriate AE regarding existence & condition of same by |
| Attendance at physical counting | - Evaluate mgt instructions for recording & controlling results of counting |
| Count conducted Other than at the date of FS | |
| Obtain AE whether change in stock properly recorded. |
| Auditor unable to attend the count | |
| Observe count on other date & perform procedure on intervening transactions |
| Unpracticable to attend count | Perform alt procedures |

| Appetdly Ccontrlving Involves | Inspecting inventory - ascertain its existence & condition, & perform physical counts. |
| Observing compliance with mgt instructions & procedures for recording & controlling count results. |
| Obtaining AE as to reliability of mgt count procedures. |

| Inventory under control of 3rd Party | * Request confirmation from the third party. |
| Inspection/other audit procedures as appropriate | |
| Obtain service auditors report w.r.t. adequacy of procedures of third party. |
| Attendig/arranging another auditor to attend third party’s counting procedure. |
| Inspecting documentation (Example - warehouse receipts). |

SA 505 EXTERNAL CONFIRMATION

| AE obtained as a direct written response to auditor from a third party, in any form/manner. |

| Positive confirmation | "Confirming party respond whether it agrees/ disagrees with info" |
| Negative confirmation | "Confirming party responds if disagrees with info provided in request." |

Use Negative Confm only if all of following are present: |
- ROMM is low |
- Effective I.C. |
- Item contains small amt |
- Expected Low exception rate |
- No reason to believe recipient may disregard request |

| Reliability of Response | * Objectivity of confirming party: Responses to not believable if confirming party related to the client. |
| Knowledge about the matter: Depends on knowledge of confirming party about subject matter being confirmed. |
| Williness of third party to respond: Third party may consider responding time consuming/costly affair." |

| External Confirmation Procedures | 1. Determine info to be confirmed |
| 2. Select appro. party |
| 3. Designing request |
| 4. Sending request including follow up request |

Factors to consider when designing requests | * Identified ROMM, including fraud risks. * Layout & presentation of request. |
| Prior experience | * Assessments being addressed. |
| Method of communication - Mgt authorisation/encouragement to confirming parties to respond to the auditor. |
| Ability of intended party to confirm or provide requested information |

In case of no response: Perform Alt procedures |

|Mgt’s refusal not appropriate: Communicate with TCWG & assess impact on opinion |
**CHAPTER 3 - AUDIT DOCUMENTATION AND AUDIT EVIDENCE**

**SA 560 SUBSEQUENT EVENTS**

Subsequent events - Events occurring by date of FS & date of the auditor’s report, and facts that became known to the auditor after the date of the auditor’s report.

**Facts become known to auditor after date of auditor’s report before date FS issued**

- Auditor has no obligation to perform procedures regarding FS after date of auditor’s report.
- When, after the date of report but FS issued, a fact becomes known that has been known may have caused auditor to amend report, auditor shall:
  a. Discuss the matter with mg & TCWG;
  b. Determine FS need amendment and, if so,
  c. Inquire how mgt intend to address the matter in FS-

If mgmt amends, auditor shall:

- a. Extend procedures referred to the date of the new auditor’s report; and
- b. Provide anew auditor’s report

- “When mgtx does not amend FS in but where auditor believes they need to be amended, then
  a. If the report has not yet been provided to the entity, the auditor shall modify the opinion;
  b. If the auditor’s report has already been provided, auditor shall notify mg & TCWG, to issue FS to 3rd parties if FS are issued without necessary amendments, auditor shall take appropriate action, to seek toprence reliance on the auditor’s report.

**Events occurring by date of FS & date of auditor’s report**

- Obtain sufficient appropriate AE, all events occurring between the date of FS & date of auditor’s report that require adjustment disclosure in FS have been identified.
- Auditor shall:
  a. Obtain understanding of any procedures mgtx established to ensure subsequent events are identified.
  b. Inquiring of mgtx and TCWG;
  c. Read minutes of the meetings, of the entity’s owners, mgtx & TCWG held after date of FS; Read the entity’s latest subsequent interim FS, if any

**SA 576 GOING CONCERN**

- Mgt Responsibilities
  - Assess entity’s ability to continue as going concern.
  - In case FS not prepared on going concern basis - Fact to be disclosed in FS

- Auditor responsibility/ Objectives
  - Obtain SAA to about appropriateness of mgt’s use of going concern.
  - Consider whether there is material uncertainty about entity’s ability to continue as going concern.

**SA 570 EVALUATING MANAGEMENT'S ASSESSMENT**

- Auditor shall cover same period as that used by mgtx. If mgtx’s assessment of the entity’s ability to continue as going concern covers less than 12 months from the date FS, auditor shall require mgtx to extend its assessment period to at least 12 months from that date.
- In evaluating mgtx’s assessment, auditor consider whether mgtx’s assessment includes all relevant info of which auditor is aware.

**SA 550 RELATED PARTIES (RP)**

**Risk assessment procedures and related activities**

1. Understanding the entity’s related party relationships and transactions
   - Inquire mgtx regarding:
     a. Identity of entity’s RP, including changes from the prior period;
     b. Nature of the relationships between the entity & these RP; and
     c. Whether entity entered into any transactions with these RP during the period & if so, the type & purpose of transactions.
   - Obtain understanding of controls that has been established to:
     a. Identify, account for, & disclose RP relationships & transactions
     b. Authorize & approve significant transactions & arrangements
     c. Authorize & approve significant transactions & arrangements other than normal course of business.

2. Maintaining alertness for RP info
   - Auditor shall remain alert, when inspecting records/documents, for arrangements (other info that may indicate existence of RP relationships/transactions not previously identified or disclosed to the auditor. If the auditor identifies significant transactions outside the entity’s normal course of business, auditor shall inquire mgtx about nature of these transactions & whether RP could be involved.

**Identification of previously unidentified/unreported RP or significant RP transactions**

- Communicate relevant info to the other members of ET
  - Where applicable FRF establishes RP requirements:
    i. Request mgtx to identify all transactions with newly identified RP for the auditor’s further evaluation; &
    ii. Inquire why entity’s controls over RP relationships & transactions failed to enable identification / disclosure
  - Perform appropriate substantive procedures relating to such newly identified RP or RP transactions;
  - Reconsider risk that other unidentified RP or significant RP transactions may exist
    - If the non-disclosure by mgtx appears intentional evaluate the implications for the audit

**Identification significant RP transactions outside the entity’s normal course of business.**

- Inspect underlying contracts/agreements & evaluate:
  i. Business rationale of transactions
  ii. Terms of transactions, are consistent with mgtx/plan expires & payments on FRF
  - Transactions appropriately accounted for & disclosed in accordance with the applicable FRF; &
  - Obtain AE transactions have been appropriately authorized & approved.

**SA 540 WRITTEN REPRESENTATIONS (WR)**

**Objectives of the auditor**

- To obtain WR from mgtx that believes that it has fulfilled the fundamental responsibilities.
  - To support other AE by means of WR &
  - To respond appropriately to WR provided by mgtx.

**Date and period covered by WR**

- WR shall be for all FS and periods referred to in the auditor’s report.

**Doubt as to the reliability of written representations**

- If auditor has concerns about competence, integrity, ethical values or diligence of mgtx, auditor shall determine their effect on reliability of representations.
  - In particular, if WR inconsistent with other AE, auditor perform procedures to attempt to resolve the matter &
  - If the auditor concludes that WR are not reliable, auditor shall take appropriate actions, including determining possible effect on the opinion.

**Requested written representations not provided**

- He shall discuss the matter with mgtx & re-evaluate reliability & integrity of mgtx. Also consider its effect on audit report.

**Additional Procedures if Event/Condition Identified**

- Further obtain WR if mgtx or mgtx’s representative who is aware may cast significant doubt on the entity’s ability to continue as going concern.
  - Procedures shall include:
    - Mgt not performed assessment, requesting mgtx to make its assessment;
    - Evaluating mgtx’s plans for future actions
    - Evaluating the reliability of underlying data to prepare the cash flow forecast; &
    - Determining if the entity’s financial statements remain appropriate underlying forecast
  - Considering any addt facts or info become available since date on which mgtx made its assessment,
  - Requesting WR from mgtx & TCWG, regarding their plans for future actions

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CHAPTER 4 - RISK ASSESSMENT AND INTERNAL CONTROL

Audit Risk (AR) and Its Components

- Auditors may give inappropriate opinion when FS materially misstated

Inherent Risk (IR)
- "Sufficiency of an account balance/class of transactions to a material misstatement, assuming that there were no internal controls."

Control Risk (CR)
- Risk that material misstatement will not be prevented/detected & corrected on timely basis by the IC system.

Detection Risk (DR)
- Risk that the substantive procedures performed by the auditor fail to detect material misstatement.

What is not included in Audit Risk

1. Risk that auditor might express an opinion that FS are materially misstated when they are not. This risk is ordinarily insignificant.
2. It does not refer to the auditor's business risks such as loss from litigation, adverse publicity, or other events arising in connection with the audit of FS.

Risk of Material Misstatement (ROMM)

- ROMM exists at 2 levels:
  1. IR
  2. CR

Relationship of IR & CR
- Mgt reacts to IR by designing accounting & IC systems, & therefore, in many cases, IR and CR are highly interrelated.

Inverse relationship b/w CR and the combined level of IR and CR.

Conditions which increase risk of fraud/Risk requiring special audit consideration

1. Weaknesses in design of IC system & non-compliance with the laid down procedures.
2. Doubts about the integrity or competence of the mgt.
3. Unusual or unexplained changes in accounts.
4. Unusual transactions or transactions with related parties.
5. Problems in obtaining SAAR, e.g., inadequate documentation.

IC and IT Environment

Benefits of IT to IC
- Reliance on systems or programs accurately processing data, processing inaccurate data or both: Unauthorised access to data
- Possibility of IT personnel gaining access beyond those necessary to perform their assigned duties there by breaking down SOD
- Unauthorised changes to data in Master files.
- Unauthorised changes to systems or programs.
- Failure to make necessary changes to systems or programs - Inappropriate manual intervention
- Potential loss of data or inability to access data as required.

Risk to IC imposed by IT
- Consistently apply predefined business rules & perform complex calculations
- Enhance timeliness, availability, & accuracy of info;
- Facilitate addn analysis of info;
- Enhance ability to monitor performance of entity's activities;
- Reduce risk that controls will be circumvented- Enhance ability to achieve effective SOD.

Assessment of Controls
- Review of IC by auditor
- Open communication channel
- Less structured for small entities
- Monitoring of Control
- Helps in assessing the effectiveness of controls on a timely basis
- Mgt accomplishes it through ongoing activities, separate evaluations, or a combination of the two.
- Mgt's monitoring activities may include using info from communications from external parties.

Satisfactory control environment not absolute deterrent to fraud
- Work as positive factor when the auditor assesses the ROMM
- Deficiencies in control environment may undermine the effectiveness of controls, in particular, an implication to fraud.
- Control environment influences the NTE of auditor's further procedures.
- Control environment does not prevent, or detect & correct, a material misstatement. Influence the auditor’s evaluation of the effectiveness of other controls and thereby auditor’s assessment of ROMM.

Testing of IC system (TOS) - includes
- Inspection of documents to test AE Pat IC have operated properly.
- Inquiry & observation of IC
- Re-performance of IC
- Testing on computerized application

SA 315 IDENTIFYING AND ASSESSING RISK OF MATERIAL MISSTATEMENT

Inquiries of mgt & others within the entity
- Analytical Procedures
- Observation & Inspection

Internal Control (IC)
- Process designed, implemented & maintained by TCGW, mgt & other personnel to provide reasonable assurance about achievement of an entity's objectives with regard to:
- Reliability of financial reporting.
- Effectiveness & efficiency of operations.
- Safeguarding of assets, and
- Compliance with applicable laws and regulations.

Limitations of IC
- IC provide reasonable assurance
- Human judgment in decision making
- Collusion among people
- Lack of understanding the purpose
- Limitation in case of small entities

AR = CR x IR (ROMM) x DR

Components of IC System

1. Control Environment
- Control environment includes:
  1. governance & mgm't functions
  2. attitudes, awareness, & actions of TCGW & mgmt.
  3. If sets the tone of an organisation

Elements of Control Environment
- Communication & enforcement of integrity & ethical values
- Commitment to competence
- Participation by TCGW
- Mgt's philosophy operating style & Organisational structure
- Assignment of authority & responsibility
- HR policies & practices

2. Entity's Risk assessment process
- Policy Manuals & Financial Reporting Manuals

3. The Info system, including the related business processes, relevant to financial reporting & communication
- Auditor to obtain understanding of:
  1. Classes of transactions significant to FS
  2. Procedures by which those transactions are initiated, recorded, processed, corrected as necessary, transferred to OL, and reported
  3. Related A/c records, supporting info & specific accounts used to initiate, record, process & report transactions
  4. How info system captures events & conditions significant to FS
  5. The financial reporting process
  6. Controls surrounding journal entries.

Obtain understanding of how entity communicates financial reporting roles & responsibilities b/w mgmt & TCGW and external communications

Following pts need consideration
- Understanding of Roles & Responsibilities
- Understanding relation of activities

4. Control Activities
- Open communication channel
- Less structured for small entities

Evaluation of IC by auditor
- Review of IC will enable auditor to know:
  1. Errors & frauds likely to be located
  2. Adequate IC system is in use & operating as planned by mgmt
  3. Effective internal audit dept is operating
  4. Any admin control has a bearing on work
  5. Controls adequately safeguard assets
  6. How far & adequately mgmt is discharging its function
  7. How reliable reports, records & the certificates to mgmt can be.

Satisfactory control environment not absolute deterrent to fraud
- Work as positive factor when the auditor assesses the ROMM
- Deficiencies in control environment may undermine the effectiveness of controls, in particular, an implication to fraud.
- Control environment influences the NTE of auditor's further procedures.
- Control environment does not prevent, or detect & correct, a material misstatement. Influence the auditor’s evaluation of the effectiveness of other controls and thereby auditor’s assessment of ROMM.
CHAPTER 4 - RISK ASSESSMENT AND INTERNAL CONTROL

SA 320 MATERIALITY IN PLANNING AND PERFORMING AN AUDIT

Meaning of Materiality

- Misstatements are material if they influence economic decisions of users.
- Judgments are made in light of surrounding circumstances, and are affected by size/nature of a misstatement.
- Based on consideration of common financial info needs of users as a group.

Relevance of Materiality

1. Revise materiality for FS as a whole.
2. If the auditor concludes that a lower materiality for FS as a whole initially determined is appropriate, he shall determine whether it is necessary to revise performance materiality, and whether the NTE of the further audit procedures remain appropriate.

Judgement of Materiality provides basis for:

- Determining NTE of risk assessment procedures
- Identifying & assessing ROMM, Determining NTE of further audit procedures

"Performance materiality" means assessed by auditor materiality for FS as a whole to reduce to an appropriately low level probability that aggregated uncorrected & undetected misstatements exceeds materiality for FS.

Use of Benchmarks in determining Materiality

- Factors that may affect identification of appro. Benchmark includes:
  - Elements of the FS - Items on which attention of users tends to be focused
  - Nature of entity, where entity is at in its lifecycle, & industry & economic environment in which entity operates;
  - Ownership structure & the way it is financed &
  - Relative volatility of benchmark.

Method to review IC system

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<td>Exhaustive description of system as found in operation by the auditor.</td>
<td>Series of questions which a member of the auditing staff must answer.</td>
<td>Comprehensive series of questions concerning internal control.</td>
<td>Graphic presentation of each part of the company's system of internal control.</td>
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<td>Advantages</td>
<td>Identify weaknesses/gaps incorporate changes on account of change in team</td>
<td>Motivating as on the job requirement</td>
<td>Recommendation can be easily provided by auditor Easy location of weakness</td>
<td>Concise presentation Easily understandable Complete view of system</td>
</tr>
<tr>
<td>Disadvantages</td>
<td>Time consuming Doesn't identify weakness in the system</td>
<td>Time consuming</td>
<td>Time consuming</td>
<td>Time consuming</td>
</tr>
</tbody>
</table>

Advantages

- Identify weaknesses/gaps incorporate changes on account of change in team

Disadvantages

- Time consuming
- Doesn't identify weaknesses in the system

Objectives of Auditor

Objectives of external auditor, where external auditor expects to use internal auditor's work or use internal auditors to provide direct assistance, are:

a. To determine work of the internal audit function/direct assistance can be used, and if so, in which areas & to what extent
b. If using work of the function, to determine that work is adequate for his purpose
c. If using internal auditors to provide direct assistance, to appropriately direct, supervise & review their work.

Determining Whether, in Which Areas, and to What Extent IA Work of Internal Audit Function Can Be Used

- Extent to which the function's organizational status & relevant policies & procedures support objectivity of IA;
- Level of competence of the function;
- Whether function applies a systematic & disciplined approach, including quality control.

Determining nature & extent of work of the function that can be used

1. Consider nature & scope of work performed/planned to be performed
2. External Auditor make all significant judgments and, use less work of the function & perform more of work directly.
3. External auditor evaluate whether, using work of IA would still result in him being sufficiently involved in audit. External auditor communicate how he plans to use the work of the function.

Determining whether IA work of internal audit function can be used to provide direct assistance

"1. External auditor evaluate existence & significance of threats to objectivity & level of competence of IA;
2. External auditor not use IA to provide direct assistance if:
   a. There are significant threats to objectivity of IA
   b. IA lacks sufficient competence to perform proposed work"

Determining nature & extent of work that can be assigned to IA providing direct assistance

"External auditor shall consider:
1. The amount of judgment involved in:
   a. Planning and performing relevant audit procedures;
   b. Evaluating the audit evidence gathered;
   c. Assessed ROMM"
**CHAPTER 5 - FRAUD AND RESPONSIBILITY OF AUDITOR IN THIS REGARD**

### Fraud Reporting (Sec 143(12) & Rule 13)

<table>
<thead>
<tr>
<th>Amt &lt; 1 cr</th>
<th>Amt 1cr or above</th>
</tr>
</thead>
<tbody>
<tr>
<td>Report to Board/AC</td>
<td>Disclosure in Board report</td>
</tr>
<tr>
<td>Within 2 days of know - Report to Board/AC</td>
<td>Seeking reply in 45 days</td>
</tr>
</tbody>
</table>

### Report to CG

- **Sec 143(13)**
  - Auditor not guilty of breach of any duties by reason of reporting to CG

- **Sec 143(14)**
  - Provision of fraud applies to CS - secretarial audit & CMA - cost audit

- **Sec 143(15)**
  - Penalty for non-compliance of Sec 143(12) - Listed co. - 5L and Any other co. - 1L

### Reporting under Clause (x) of CARO 2020

- Any fraud by co or any fraud on Co has been noticed/reported. If yes, nature & amt involved is to be indicated.

### Types of misstatement relevant to auditor

- Defalcation of cash
- Inflating payment
- Suppressing receipts: Teeming and lading

### Misstatements resulting from fraudulent financial reporting

1. **Incentives/Pressure** - High competition with declining margin; High vulnerability to rapid changes; Decline in customer demand
2. **Opportunities** - Known history of violation of laws; significant RP transactions; Ability to dominate the industry
3. **Attitudes/Rationalization** - Mgt unable to remedy deficiency in IC; Excessive pressure by Mgt in maintaining earning trend

### Misstatements resulting from misappropriation of assets

1. **Incentives/Pressure** - Personal financial obligation of employee; Adverse relationship with employee
2. **Opportunities** - Large amount of cash on hand; Inventory item with high value & small size; Inadequate IC over assets
3. **Attitudes/Rationalization** - Disregard for need of reducing risk related to misappropriation of asset; Disregard for IC over assets

### Auditor unable to continue engagement

- Determine professional & legal responsibilities- Whether it is appropriate to withdraw from engagement
- If auditor withdraws:-
  - a) Discuss with mgt & TCWG along with reasons for withdrawal
  - b) Whether any requirement to report to any person

### Circumstances relating to possibility of fraud

<table>
<thead>
<tr>
<th>Discrepancies in A/c records</th>
<th>Conflicting/misleading evidence</th>
<th>Others</th>
</tr>
</thead>
<tbody>
<tr>
<td>Problematic/unusual relationship with mgt</td>
<td></td>
<td></td>
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</tbody>
</table>

### Manipulation of Accounts - generally committed to

<table>
<thead>
<tr>
<th>By:-</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Inflating/suppressing purchases/expenses/sales</td>
<td></td>
</tr>
<tr>
<td>Receiving high salary</td>
<td></td>
</tr>
<tr>
<td>Inflating/deflating closing stock</td>
<td></td>
</tr>
<tr>
<td>Charging capex to revenue/ vice versa</td>
<td></td>
</tr>
<tr>
<td>Failing to adjust o/s liability/prepaid expense</td>
<td></td>
</tr>
<tr>
<td>Misapplication of A/c policies</td>
<td></td>
</tr>
</tbody>
</table>

### Fraud Risk Factors

- Concealing facts
- Inflating payment
- Suppressing receipts: Teeming and lading

### Auditors:

- **Primary responsibility for prevention & detection of fraud rests with TCWG and mgt.**

- **Meaning of Fraud**: Intentional act by one/more individuals among mgt, TCWG, employees, or 3rd parties, involving use of deception to obtain unjust/illegal advantage

- **Risk of not detecting material misstatement resulting from fraud higher than risk of not detecting one resulting from error**

  - Fraud involve sophisticated & carefully organized schemes designed to conceal it - Concealment even more difficult to detect when accompanied by collusion - Difficult to determine misstatements in judgment areas such as accounting estimates

- **Risk of not detecting a material misstatement resulting from mgt fraud is greater than for employee fraud**

- **Fraud Risk Factors**

  - Consequences of know - Amt 1cr or above
  - Within 2 days of know - Seeking reply in 45 days

- **Fraud Factors**

  - Inflating/deflating closing stock
  - Suppressing receipts: Teeming and lading

- **Types of misstatement relevant to auditor**

  - Defalcation of cash
  - Inflating payment
  - Suppressing receipts: Teeming and lading

- **Misstatements resulting from fraudulent financial reporting**

  - Incentives/Pressure - High competition with declining margin; High vulnerability to rapid changes; Decline in customer demand
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- **Reporting under Clause (x) of CARO 2020**

  - Any fraud by co or any fraud on Co has been noticed/reported. If yes, nature & amt involved is to be indicated.
CHAPTER 6 - AUDIT IN AUTOMATED ENVIRONMENT

Types of controls in automated environment

<table>
<thead>
<tr>
<th>Objectives</th>
<th>Data Centre &amp; Network oper</th>
<th>Program Change</th>
<th>Access Security</th>
<th>App system</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Production systems processed to meet financial reporting objectives</strong></td>
<td><strong>Modified systems continue to meet financial reporting objectives</strong></td>
<td>Access to programs &amp; data authorized &amp; controlled</td>
<td>Systems developed, configured &amp; implemented to meet the objectives</td>
<td></td>
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<tr>
<td><strong>Mgt of computer operations activities</strong></td>
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<tr>
<td><strong>Failure recovery</strong></td>
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<tr>
<td><strong>Documentation</strong></td>
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<tr>
<td><strong>Service level agreement</strong></td>
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<tr>
<td><strong>Performance monitoring</strong></td>
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<tr>
<td><strong>Mgt of development activities</strong></td>
<td></td>
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<tr>
<td><strong>Project initiation</strong></td>
<td></td>
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<td></td>
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<tr>
<td><strong>Analysis &amp; design</strong></td>
<td></td>
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<td></td>
<td></td>
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<tr>
<td><strong>Construction</strong></td>
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<tr>
<td><strong>Data conversion</strong></td>
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</tbody>
</table>

Some situations in which IT will be relevant to an audit

- Increased use of Systems & Application software
- Complexity of transactions has increased
- Hi-tech nature of business
- Volume of transactions are high
- Company Policy
- Regulatory requirements - Companies Act 2013
- Required by Indian & International Standards - ISO
- Reduced time & effort required for auditing
- Improved accuracy & efficiency of audit.

Testing Methods

- A. Obtain understanding how an automated transaction is processed by doing a walkthrough
- B. Observe how users process transactions in different scenarios
- C. Inspect Rec. configuration defined in application.
- D. Inspect system logs to determine changes made
- E. Inspect user manual of systems & applications.
- F. Carry out test check & observe error message displayed
- G. Re-performance using raw source data

Relevance of IT in an audit

- "When business operate in automated environment - we will see several business functions & activities happening within the systems. Consider the following aspects instead of -
- Computer & Calculations automatically carried out
- A/c entries posted automatically
- Business procedures & policies, including IC. applied automatically
- Reports produced from systems. Mgt & other stakeholders rely on these reports & info produced
- User access & security controlled by assigning system roles to users"

Risk Assessment

- Identify A/c and disclosures
- Qualitative & quantitative consideration
- Relevant FSA
- Identify source- Consider IT risk

Audit Approach

- Document understanding of business process
- Prepare RCM
- Underest design of controls throughout walkthrough
- Process wise consideration for ELC/SCD
- IT general, App controls
- Assess NTE of control testing
- Assess reliability & completeness of source data
- Test key reports
- Sample testing
- Competence/ capability/ independence of staff/team
- Evaluate deficiencies
- Remediation of weaknesses

Data Analytics

- "Tools & techniques used in applying principles of data analytics - CAATs"
- "Tools & techniques used in applying principles of data analytics - CAATs"

Steps in use of CAAT

- 1. Understand business env including IT
- 2. Define Objectives & criteria
- 3. Identify source & format of data
- 4. Extract Data
- 5. Verify completeness & accuracy of data
- 6. Apply criteria on data obtained
- 7. Validate & confirm results
- 8. Report & document results

![Image]

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Some features & requirements for providing hi-tech accuracy in automated environment

- Process large volume of transactions in less time
- Accuracy in computations & data processing
- Providing latest info
- Networking capabilities, better connectivity & integration between business operations is possible.

Understanding automated environment

<table>
<thead>
<tr>
<th>Info System being used</th>
<th>Its purpose</th>
<th>Location of IT system</th>
<th>Interface with system</th>
<th>Architecture</th>
<th>Version</th>
<th>Key persons (CSO, CISO)</th>
<th>Inhouse Vs packages</th>
<th>Outsourced activities</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
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</tr>
</tbody>
</table>

Risks in IT system

- Inaccurate data processing
- Unauthorized access
- Direct data changes
- Excessive access
- Inadequate SOD
- Unauthorized Changes
- Loss of Data

Impact of IT risks on controls, substantive procedures & reporting

<table>
<thead>
<tr>
<th>Substantive Procedures</th>
<th>Reporting</th>
<th>Control</th>
</tr>
</thead>
<tbody>
<tr>
<td>- can't rely on data processed</td>
<td>- Communicate with TOCAI &amp; Reporting &amp; Auditing (RA)</td>
<td>- Mgt of automated controls &amp; High control risk</td>
</tr>
<tr>
<td>- Need to test the program</td>
<td>- Report's 143(3)</td>
<td>- Test system data &amp; report</td>
</tr>
<tr>
<td>- Completeness &amp; accuracy of reports to be tested</td>
<td>- Modification of opinion</td>
<td>- Can't rely on automated controls</td>
</tr>
<tr>
<td>- Obtain more evidence</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Meaning:- Business environment where processes, operations, A/c & even decisions carried out using computer systems - also known as Information Systems (IS) or Information Technology (IT) systems.

<table>
<thead>
<tr>
<th>Features of Automated environment</th>
</tr>
</thead>
<tbody>
<tr>
<td>* Enabling business operations at a faster speed</td>
</tr>
<tr>
<td>* Reduced &amp; efficient error management</td>
</tr>
<tr>
<td>* Process large volume of transactions in less time</td>
</tr>
<tr>
<td>* Accuracy in computations &amp; data processing</td>
</tr>
<tr>
<td>* Providing latest info</td>
</tr>
<tr>
<td>* Networking capabilities, better connectivity &amp; integration between business operations is possible.</td>
</tr>
</tbody>
</table>

Some key points of audit in automated environment

- All relevant aspects of IT need to be covered during audit
- A lot of automated controls to be tested & verified
- Consideration of source大大小 |

Low Efficiency High Efficiency

- Inquiry
- Observation
- Inspection
- Re-performance

Time Low High

- Risk assessment
- Audit & evaluate
- Testing for effectiveness
- Reporting

Use of Data Analytics

- Check completeness of data & population- Selection of audit samples
- Re-computation of balances- Re-performance of mathematical calculations
- Analysis of JE as required by SA 240
- Fraud investigation.
- Evaluating impact of control deficiencies
- Identifying inconsistencies or significant fluctuations

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CHAPTER 7 - AUDIT SAMPLING (SA 530)

Advantages of Statistical Sampling:
- Better description of large mass of data
- Reduced sampling risk
- Provides means of estimating min sample size
- Objective method
- Sample size not increase proportion to increase in size of area

Precautions while conducting test checking
- Thorough understanding of Ac & IC system
- Area not suitable for sampling (Bank confirmation)
- Proper planning and classification
- No bias and Analysis of misstatement

Population
Meaning: Entire set of data from which sample is selected & about which auditor wishes to draw conclusions.
Characteristics of population
- Appropriateness
- Accuracy
- Completeness

Approaches to Sampling
- Statistical
- Non Statistical/Judgmental

Statistical
- More scientific
- Use of law of probability
- No personal bias

Non Statistical/Judgmental
- Based on personal experience & knowledge of auditor
- "Limitation of non statistical method:-
  a) Neither objective nor scientific
  b) Risk of personal bias"

"Advantages of Statistical Sampling:-
- a) Sample size not increase proportion to increase in size of area
- b) Objective method
- c) provides means of estimating min sample size
- d) Reduced sampling risk
- e) Better description of large mass of data"

Performing Audit Procedures
Auditor perform procedures on each item selected. If procedure not applicable, auditor perform procedure on replacement item. If auditor unable to apply designed procedures, treat that item as deviation in case of TOD, or a misstatement, in case of TOD.

Sample Design
- When designing an audit sample, Auditor to consider:-
  - Specific purpose to be achieved
  - Determine stratification/value-weighted appropriate

Stratification
- "Reduce variability of items with in each stratum
  This allows greater audit effort to be directed to larger value items
  Results of procedures applied to sample of items within stratum can only be projected to that stratum."

Value Weighted Selection
- "Identify sampling unit as individual monetary units
  Examine particular items contain the units
  Effort directed to larger value items This may be
  used in conjunction with systematic method of sample selection"

Sample selection Method
- 1. Random - Simple random; Stratified random
- 2. Interval Sampling
- 3. Monetary Unit
- 4. Haphazard
- 5. Block selection

Auditor's conclusion based on sample diff from conclusion if entire population subject to same procedure. Can lead to two types of erroneous conclusions:
- a) TOD - controls are more effective/TOD - material misstatement doesn't exist
- b) TOD - Controls less effective / TOD - material misstatement exists

Factors affecting sample size in TOC
- "Increased samples size:-
  H - Reliance on control
  L - Tolerable deviation rate
  H - Expected deviation rate
  H - Desired assurance level
  H - Population size"

Factors affecting sample size in TOD
- "Increased samples size:-
  H - ROMIL - Reliance on substantive
  L - Tolerable misstatement
  H - Desired assurance level
  H - Expected misstatement"

Meaning - Application of audit procedures to less than 100% of items within a population - all sampling units have a chance of selection in order to provide auditor with a reasonable basis on which to draw conclusions about entire population.

Meaning - Examine < whole population
Objective - Form opinion on FS
Nature - Judgmental/statistical
Level of function - By higher lvl audit staff
Time - Saves time of audit staff

Saves time of audit staff
More time consuming

Obtain broad view of scale but it may not determine amount to be recorded. When misstatement established as anomaly, excluded when projecting misstatements. For TOD, the auditor project misstatements to population whereas for TOC, no projection of deviations necessary.

Characteristics of population
- Appropriateness
- Accuracy
- Completeness

Statistical
- Non Statistical/Judgmental

Applicability of audit procedures to examine particular items contain the units. Effort directed to larger value items. This may be used in conjunction with systematic method of sample selection.

Sample selection Method
- 1. Random - Simple random; Stratified random
- 2. Interval Sampling
- 3. Monetary Unit
- 4. Haphazard
- 5. Block selection

Auditor's conclusion based on sample diff from conclusion if entire population subject to same procedure. Can lead to two types of erroneous conclusions:
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- "Increased samples size:-
  H - ROMIL - Reliance on substantive
  L - Tolerable misstatement
  H - Desired assurance level
  H - Expected misstatement"
CHAPTER 8 - ANALYTICAL PROCEDURES (SA 520)

Meaning: - Evaluation of financial info through analysis of plausible relationship among both financial & non-financial data.

Auditor’s choice of procedures, methods & level of application is matter of professional judgment.

Timing of Analytical Procedures

1. At planning stage - assist in risk assessment procedure & help in determining NTE of other procedures.
2. While performing audit
   a. Procedures at assertion level may be TTD, substantive analytical procedures, or a combination of both.
   b. Decision about which audit procedures to perform based on auditor’s judgment
   c. Inquire mgt as to availability & reliability of info needed to apply substantive analytical procedures
3. Near end FS are consistent with his understanding*

Nature of Analytical Procedures

"Consideration of comparisons of financial info with:
a. Comparable info for prior periods.
   - Anticipated results
   - Similar industry info"

"Consideration of relationships such as:
- Among elements of financial info
- Bw financial info & relevant non-financial info"

Factors to be considered for substantive analytical procedures

1. Availability of Data - Availability of reliable & relevant data will facilitate effective procedures
2. Disaggregation - Degree of disaggregation directly affect degree of its usefulness
3. Account Type - Analytical procedures more useful for certain accounts than for others. Income statement accounts tend to be more predictable, whereas balance sheet accounts are subject to greater mgt judgment
4. Source - Some classes of transactions tend to be more predictable as they consist of numerous similar transaction
5. Predictability - More appropriate when account balance/relationships bw items of data are predictable
6. Nature of Assertion - More effective in providing evidence for some assertions (e.g., completeness or valuation) than for others (e.g., rights and obligations)
7. Inherent Risk - When IR higher, design TDD to address it. When significant risks identified, AE obtained solely from analytical procedures is unlikely to be sufficient.*

Techniques available as substantive analytical procedures

1. Trend analysis - Comparison of current data with prior period balance or with trend in 2 or more prior period
2. Ratio analysis - Useful for analysing asset & liability A/c & revenue & expense A/c. Individual balance sheet A/c difficult to predict on its own, but its relationship to another account often more predictable Ratios can be compared over time or to ratios of separate entities within group, or with ratios of other companies in same industry.
3. Reasonableness tests - Rely upon non-financial data for audit period under consideration (e.g. occupancy rates to estimate rental income or interest rates to estimate interest income or expense). More applicable to income statement accounts and certain accrual or prepayment accounts.
4. Structural modelling - Constructs statistical model from financial and/or non-financial data of prior accounting periods to predict current account balances (e.g., linear regression).*

Considerations in designing analytical procedures

1. Determine the suitability of particular procedures for given assertions, taking account of the assessed ROMM & TDD, if any, for these assertions;
2. Evaluate reliability of data from which auditor’s expectation of recorded amts/ratios developed, taking account of source, comparability, & nature & relevance of info available, & controls over preparation;
3. Develop expectation of recorded amts/ratios & evaluate expectation sufficiently precise to identify a misstatement. Determine amt of any diff of recorded amts from expected values acceptable without further investigation.*

Suitability of particular analytical procedures for given assertions

1. Analytical procedures more applicable to large volumes of transactions that tend to be predictable over time. Based on expectation relationships among data exist & continue in absence of known conditions to the contrary
2. In some cases, even unsophisticated predictive mode maybe effective as analytical procedure.
3. Different types of analytical procedures provide different levels of assurance.
4. Determination of suitability of particular analytical procedures influenced by nature of assertion and ROMM*

Extent of reliance on procedures influenced by:-

- Source of the information available.
- Comparability of the information available.
- Nature and relevance of the information available.
- Controls over the preparation of the information.

Evaluation whether expectation is sufficiently precise

- Accuracy with which expected results can be predicted.
- Degree to which info can be disaggregated.
- Availability of info, both financial & non-financial.

Investigating results of analytical procedures

1. Analytical procedures performed stand alone or that differ from expected values by a significant amount, auditor shall investigate such differences by:-
   i. Inquiring mgt & obtaining appropriate AE
   ii. Performing other procedures as necessary in the circumstances.*

Considerations specific to Public sector entities

- Relationship bw individual FS items traditionally considered may not always be relevant.
- Expense on acquisition of assets not capitalised.
- Industry data/statistics for comparison not available.*

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